# Enron revisited: Why the 'tone at the top' is crucial to adequate Risk Management and Compliance

*During my workshops about risk management and governance in the power and gas industry I always show a part of the documentary " the smartest guys in the room" about the downfall of Enron. The part that I show is to highlight the importance of the tone at the top and the impact that this tone will have on the behavior of the traders. If the tone is we only have one value and that is making money, the traders will lose all sense of morality and for instance get away with ignoring any orders by risk and compliance managers. Actually making risk management or compliance paper tigers.*

The Enron demise was in 2001 and one should expect that the industry would have learned valuable lessons about how not do it. However, as we also have seen in the banking industry, companies do have short memories.

So after a couple of years the  bad behaviors might roar its ugly head again. A good example of this is Nidera an agri and sustainable energy trading firm with its headquarters in Rotterdam, the Netherlands.

Last year, a rogue trader was discovered at Nidera. Tim Remie, senior biodiesel trader, has been grossly overstepping his limits in his futures trade deals. The damage runs into the tens, even hundreds of millions of euros. Remie is suspected to have raked in 1.2 million euros behind the backs of his employers.

Nidera dismisses the case as an incident. However, it turned out that rogue trader Remie was anything but a lone wolf. This was not an isolated incident, but Tim Remie's behavior is a symptom of Nidera's corporate culture. That is Nidera is a trading firm in which traders have been pushing — and, at times, grossly overstepping — the boundaries of trading ethics for years. It is a culture in which risk management, IT and compliance was full of holes.

In the end everything revolves around making money. If there's an opportunity, the traders will always go for it right away.  The traders' motto is : 'full speed ahead, catch those opportunities and we'll do the paperwork later.

Nidera's business culture was to look for lucrative businesses all around the globe. Lucrative means profitable, but risky business from which traders can make big bonuses. Nidera's traders did earn absolute top salaries and brought home hundreds of thousands — even millions, if the trader does an exceptional job — of euros in bonuses.

It is not unusual for managers to receive six to eight percent of their department's profits in bonuses.

The result was that traders are highly eager to make as many deals as possible. One former Nidera employee has a fitting description of this trade culture: 'It's Peter Stuyvesant's world. They make big deals at a young age, fly around the globe, make boatloads of money, and end up with a fast car and a trophy wife. And if they get kicked out somewhere, they can always fly to the Middle East and get a job there.'

In 2006, Nidera found new "opportunities" in the sustainable energy sector. They immediately set up a new department that trades in various types of biodiesel, ethanol, biomass, electricity, natural gas, and CO2 credits. Due to the boom in commodity prices business was really great to Nidera in the 2006-2008 period. In 2008, their profit reached a record size of 270 million dollars. As one trader described it : 'Everything the traders touched in the energy field increased in value by 10 percent in five minutes'.

The new energy traders received heaps of praise from Nidera's CEO. The traders were the "geniuses" during the monthly round-up sessions, but the CEO didn't know exactly how all that money was being made. That didn't matter to him, as long as the traders brought in the money.

The Risk Management department was constantly fighting with the trading floor. Risk managers need to continuously check that traders aren't taking too much risks in futures trading, and that they are maintaining realistic prices. Traders jokingly call them 'risk dogs'.

A story by a trader gives us some insight in a trader's psyche and is very telling about the mentality of the traders that the risk managers did have to fight against: 'If a deal goes wrong, the question is whether you tell your manager right away, or to just put the trade in your drawer for a while. If Risk isn't paying attention, it's in a dealer's nature to try and fix the mistake with the next trade.'

And if the deals were really broken beyond all repair, there was always another way out: the so-called 'Brazilian Hedge'. In other words: If a trader had made some bad deals, and couldn't fix it anymore he could always catch a plane to some sunny, faraway place and leaving all one's problems behind.

The fight between Risk and traders was often an unfair one, as there was a high in- and outflow of people at Risk, mostly because of young employees who saw their jobs at Risk as a way into the trade business. As a result, the ones who treated their job that way were less critical, in order to avoid fights with traders. The traders could always come up with a nice explanation to hide something.

Revealing are the observations of a former trader: Nidera often took (too) large risks. If a trader went over their limit, Risk had to "flag" them. "You still have four outstanding contracts, dude — the counterparts are going to have to pay first." Look, if you trade with a party like Shell, BP, or Mitsubishi Corporation, you know they will eventually pay their bills. But Nidera traded with everyone — including unknown parties in India and Poland. Nidera tracked those parties' credit ratings, but we were allowed to trade with category "G" companies (the lowest credit score) anyway.

And if a party wouldn't settle, and wouldn't answer the phone for weeks, the contract should have been downgraded. This didn't happen, though — those contracts were simply shoved forward in order to keep the profit margins alive.

Nidera's risk policy failed grotesquely. It turned out, that traders literally put various deals 'in the drawer' for a while. Meaning that a trader doesn't enter a futures deal right away into the system, but puts it away for a while, hoping for better market rates. Normally if a trader buys a product straight from the factory with a future delivery a year from now, they have to enter it into the computer system right away and value it at market rates. However during a period of falling market prices they would make a loss on that deal. So the deal would literally be put in a drawer in the hopes that the markets will go back up before delivery — because then the trades was hailed as the trader with the best deals again.

In 2010, due to credit line problems Nidera was forced to reorganize its risk management and replace Intras, the dated computer trading system, with a modern alternative. Intras actually was an ancient spreadsheet program and a highly opaque system that needed lengthy manuals; traders could easily hide bad deals in it.

Despite its restructuring, risk management remained anything but bulletproof. In 2015 it was reported that trader Remie did hide a derivatives deal with a Polish partner back in 2011. The loss: 1 million dollars. Regardless, Remie was allowed to stay.

For insiders it was no surprise that a trader who has crossed the line is allowed to remain at the company. 'If it turns out that a trader has signed a deal, but hasn't put the deal in the system, that's a deadly sin.

Normally, you'd kick out a guy like that, but if he brings in a lot of money, he might just get off with a warning. And if the deal turned out to do well, it would go "son, well done, but you crossed the line there. Don't do it again; here's your bonus', as former Nidera employee puts it.

All this dubious behavior stands in stark contrast to the flowery language in its ethical rules as written down in their Standards for Business Partners document. In there, Nidera claims to strive for a 'global value chain that conducts business with a high degree of integrity and in a socially and environmentally responsible manner.

In late 2014 inconsistencies in Nidera's administration were found. They lead to an internal investigation, followed by a forensic accounting investigation carried out by PwC. Traders and managers are interrogated. In April 2015, the investigation has finished; Remie is fired. He is said to have broken trade limits, and his contracts are highly overvalued.

**Lessons to be learned**

Nidera's shady bonus policy is typical for the wolf pack mentality so common among the traders, managers and shareholders throughout a trading firm, which strongly resembles a Wall Street investment bank. It says a lot that Remie, the suspect biodiesel trader, could stay under the radar for years, all the while going over trade limits and possibly making side deals to stuff his own pockets. Nidera's risk management has failed on multiple occasions over the past year; it was simply a matter of time before the next "wolf" would rear its head.

This case study highlights how crucial the tone at the top is to have a business culture that would allow for an adequate risk management and compliance execution. And remember, rogue traders could be on any trading floor, even on yours!

*Source: Follow The Money*

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